

October 27, 2003



# Financial Management

Defense Hotline Allegation on  
the Sale of Tin and the Removal  
of Asbestos at the Defense  
National Stockpile Center  
(D-2004-014)

Office of the Inspector General  
of the  
Department of Defense

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Article I, Section 9

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### **Acronyms**

DFAS	Defense Finance and Accounting Service
DFAS-GA/CO	Defense Finance and Accounting Service Office of General Counsel
DNSC	Defense National Stockpile Center
DWAS	Defense Working Capital Accounting System
FMR	Financial Management Regulation
GS	General Schedule
IG DoD	Inspector General of the Department of Defense
SFFAS	Statement of Federal Financial Accounting Standards



INSPECTOR GENERAL  
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October 27, 2003

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Defense Hotline Allegation on the Sale of Tin and the Removal of Asbestos at the Defense National Stockpile Center (Report No. D-2004-014)

We are providing this report for review and comment. We performed this audit in response to an allegation to the Defense Hotline.

DoD Directive 7650.3 requires that all issues be resolved promptly. The Defense Logistics Agency did not provide comments on a draft of this report; therefore, we request that management provide comments on this report by November 26, 2003. We expanded Recommendation A. to further clarify the need to ensure that contracting officers are held accountable for their responsibilities.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to [Audls@dodig.osd.mil](mailto:Audls@dodig.osd.mil). Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Dennis E. Payne at (703) 604-8907 (DSN 664-8907) or Mr. Albert L. Putnam at (703) 604-8779 (DSN 664-8779). See Appendix E for the report distribution. Team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

*Kimberly A. Caprio*  
to Shelton R. Young  
Director, Readiness and  
Logistics Support Directorate

## Office of the Inspector General of the Department of Defense

Report No. D-2004-014

(Project No. D2003LH-0083)

October 27, 2003

### Defense Hotline Allegation on the Sale of Tin and the Removal of Asbestos at the Defense National Stockpile Center

#### Executive Summary

**Who Should Read This Report and Why?** This report should be read by contracting officers responsible for the administration and oversight of contractor performance and other civil service and uniformed officers responsible for collecting Government debts.

**Background.** The Defense National Stockpile Center, a field activity of the Defense Logistics Agency, is the national repository of strategic materials that are critical for national defense to decrease or preclude dependency of the United States on foreign sources. The Defense National Stockpile Center is authorized by Congress to sell excess materials in the stockpile each fiscal year. In January 2003, a complaint was made to the Defense Hotline alleging that in FY 2001, the Defense National Stockpile Center lost about \$14 million on multiple sales contracts for a commodity called tin. The complainant stated that the Defense National Stockpile Center allowed a contractor to take huge amounts of tin from Defense National Stockpile Center depots without paying for it, and shortly thereafter, the contractor filed for bankruptcy. The complainant also stated that the Government lost about \$900,000 on a landfill contract for the removal of asbestos at the Defense National Stockpile Center that was awarded to a “favorite contractor,” rather than to the Army Corps of Engineers whose bid was lower than the awarded contract amount. The complainant stated that the Government lost the funds “because of irregularities, bad policy authorized by top management, and procrastination.” We performed this audit in response to the complaint.

**Results.** We substantiated the allegation on the sale of tin, but we could not substantiate the allegation on the landfill contract for the removal of asbestos. The Defense National Stockpile Center’s management of the contracts for the sale of tin mentioned in the allegation was inadequate. The Defense National Stockpile Center did not enforce the contract terms. In addition, the Defense National Stockpile Center did not have an effective debt control management program that aggressively and proactively collected contractor debts owed to the Government. The contractor was allowed to take delivery of tin on two separate contracts and was awarded a third contract while it was in default of the payment terms on the first two contracts. As a result, the Government lost about \$13.5 million on the sale of tin to the contractor (finding A). In addition, the Defense National Stockpile Center did not comply with the DoD management control plan. Planned management control reviews were not done. As a result, the Defense National Stockpile Center could not support its FY 2001 and FY 2002 Annual Statements of Assurance (finding B). The Director, Defense Logistics Agency needed to provide the Defense National Stockpile Center with oversight, guidance, and direction. See the Findings section of the report for the detailed recommendations.

**Management Comments.** A draft of this report was issued on August 11, 2003. The Defense Logistics Agency did not provide comments on the draft report. We request that the Director, Defense Logistics Agency comment on the final report by November 26, 2003.

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## Background

The Defense National Stockpile Center (DNSC) was established by the Strategic and Critical Materials Stock Piling Act, June 7, 1939, section 98, title 50, United State Code (as amended), to serve the national defense interest by acquiring and retaining stocks of certain strategic and critical materials and to encourage the conservation and development of sources of such materials within the United States to decrease and to preclude dependency on foreign sources of supplies of such materials. DNSC is also authorized to release for use, for sale, or for other disposition excess material contained in the national stockpile. However, Congress must enact specific legislation before any material determined to be excess to the needs of DoD can be disposed of. In “Strategic and Critical Materials Report to the Congress”, January 18, 2002, DNSC reported that in FY 2001, it disposed of about \$593.8 million of material from the national stockpile that included about \$26.9 million of a commodity called tin. DNSC did not report the amount spent on asbestos removal because it was not required to report that amount.

**Defense Hotline Allegation.** In January 2003, we received an allegation to the Defense Hotline that in FY 2001, DNSC lost \$14 million on multiple sales of tin to a contractor because of poor contract administration. According to the allegation, the contractor was allowed to take huge amounts of tin from various DNSC depots without paying for the tin and shortly thereafter, the contractor filed for bankruptcy. The complainant also stated that because of procrastination in the award of a landfill contract for asbestos removal, the Government lost \$900,000 when DNSC awarded a landfill contract for the removal of asbestos to a “favorite contractor” and not to the Army Corps of Engineers whose bid was lower than the awarded amount. The complainant also stated that the Government lost the funds “because of irregularities, bad policy authorized by top management, and procrastination.” We substantiated the allegation on the sale of tin (finding A), but we could not substantiate the allegation on the landfill contract for the removal of asbestos (Appendix B).

## Objectives

Our overall audit objective was to evaluate DNSC contracting policies and procedures for the sale of commodities. Specifically, we reviewed the three contracts that were the subject of the Defense Hotline allegation. We also reviewed the management control program as it related to the overall objective. See Appendix A for a discussion of the scope and methodology, our review of the management control program, and prior coverage related to the objectives.

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## **A. Management of FY 2000 and FY 2001 RMT Metals Limited Contracts for the Sale and Removal of Tin**

DNSC management of the FY 2000 and FY 2001 RMT Metals Limited (RMT) contracts for the sale and removal of tin was inadequate. DNSC contracting officers awarded RMT a third contract when it was in default of payment on the two previous contracts. Additionally, DNSC contracting officers did not implement DoD financial management regulations to protect the Government from financial losses. Those conditions occurred because DNSC contracting officials did not aggressively and proactively enforce the terms of the contracts with RMT. The contracting officials did not access the DNSC accounting systems to verify whether RMT had paid for previously released items before releasing additional material to the contractor. DNSC also did not have an effective debt control management program that aggressively and proactively collected contractor debts to the Government. DNSC contracting officers did not issue demand letters to RMT for the amounts owed to the Government. As a result, the Government lost about \$13.5 million on the sale of tin to RMT.

### **RMT Metals Limited**

RMT is based in London, United Kingdom, and had an agent in the United States. Before the award of the FY 2000 contracts, RMT had a successful contract performance history with DNSC. From FY 1994 through FY 2001, DNSC awarded 57 contracts to RMT, valued at \$219,317,154. Of the 57 contracts, 2 were for the sale and removal of lead, 3 were for the sale and removal of nickel, and 52 were for the sale and removal of tin. Of the 52 tin contracts, 3 were the subject of the Defense Hotline allegation. The actual contract price of tin removed on the three contracts was calculated by multiplying a predetermined percentage figure plus or minus a premium or discount in the previous month's London Metal Exchange price. Our audit of the three contracts revealed the following.

- On June 5, 2000, DNSC awarded two 1-year contracts to RMT for the sale and removal of tin from DNSC depots. The first contract (SP0833-00-S-00233) was for the sale and removal of 5,511,500 pounds of tin at \$2.5125 per pound, an estimated contract value of \$13,847,644. The second contract (SP0833-00-S-00234) was for the sale and removal of 6,613,800 pounds of tin at \$2.4881 per pound, an estimated contract value of \$16,455,796.
- On April 25, 2001, DNSC awarded another 1-year contract (SP0833-00-S-10129) to RMT for the sale and removal of 4,739,890 pounds of tin, at about \$2.3492 per pound, an estimated contract value of \$11,134,950.

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- On August 14, 2001, a DNSC internal review officer received an e-mail from an employee of a contractor that worked for RMT stating that RMT had failed to pay its creditors and had stopped all incoming business. DNSC took immediate action to stop further release of material from its depots to RMT and informed the RMT agent in the United States of DNSC actions.
  - On August 31, 2001, an administrator was appointed in the United Kingdom to oversee RMT affairs. At that time, about \$13.5 million of the \$31.3 million (43.1 percent) of RMT unsecured debt was owed to DNSC.
  - On August 31, 2001, DNSC Director, Directorate of Stockpile Contracts notified the court-appointed administrator of RMT of the total amount of RMT debt to DNSC.
  - On November 20, 2001, DNSC Counsel filed a creditor's statement of claim through the Assistant United States Attorney, London, United Kingdom.

## Criteria

**Federal Accounting Standards.** Statement of Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property," October 27, 1993, defines "purchase" as the date title passes to the purchasing entity and states that "if a contract between the buyer and the seller is silent regarding passage of title, title is assumed to pass upon delivery of goods. The cost of stockpile materials shall be removed from stockpile materials and reported as an operating expense when issued for use or sale." SFFAS No. 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting," April 1996, states that "when goods are kept in inventory so that they are available to customers when ordered, revenue should be recognized when the goods are delivered to the customer."

**DoD Financial Management Regulation.** The DoD Financial Management Regulation (FMR), May 1993 and subsequent changes, provides financial management regulations and procedures and assigns financial management responsibilities within DoD. The FMR is applicable to all DoD Components.

**National Defense Stockpile Transaction Fund.** FMR volume 12, chapter 22, "National Defense Stockpile Transaction Fund," September 1996, provides policies and procedures for accounting for National Defense Stockpile transactions. The policies in this chapter and other volumes of the FMR are "mandatory in accounting for, and accomplishing the information and reporting requirements applicable to the National Defense Stockpile Transaction Fund." FMR volume 12, chapter 22, section 220309, requires DNSC sales and disposal to be billed shortly after the sales agreement is made or as of the scheduled time of delivery or pickup of the material. In addition, storage fees are to be charged and billed to the purchaser for material not picked up.



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**Contractor Debt Collection.** According to FMR volume 10, chapter 18, “Contractor Debt Collection,” updated December 2001, DoD policy is to aggressively collect all Government debts. Previous editions of the FMR contained the same policies and were applicable prior to the RMT bankruptcy date. To protect the Government, contracting officers and accounts receivable staff are to work collectively to identify and correct the causes of indebtedness, delinquencies, and defaults, and take corrective actions to reduce debts owed to the Government. DoD Components are required to age their debts and document their debt collection actions. FMR requires contracting officers or designees to issue written demand for payment letters to contractors promptly and in terms that inform the debtor of the consequences for failing to resolve the indebtedness.

**Interest Charges.** According to FMR volume 10, chapter 18, amounts owed to the Government are expected to be paid in accordance with the terms specified in contracts, agreements, or the notifications of indebtedness. Interest charges are to be assessed on all late payments whether the debt is to be paid in a lump sum or by installments. In addition to the interest charges, DoD Components are required by the FMR to assess penalty charges not to exceed 6 percent per annum on any portion of a debt that is delinquent by 90 days or more.

**Title to Commodities.** FMR volume 4, chapter 18, section 180201, July 1999, states that “when goods are kept in inventory so that they are available to customers when ordered, revenue should be recognized when the goods are issued to the customer.” In accordance with the FMR, “when services are rendered continuously over time or the right to use an asset extends continuously over time, revenue should be recognized in proportion to the cost incurred or the use of the asset, as appropriate”.

**Filing Bankruptcy Proof of Claim.** According to FMR volume 10, chapter 18, the Defense Finance and Accounting Service (DFAS) Assistant General Counsel, (DFAS-GA/CO) is responsible for filing contractor bankruptcy proof of claims within DoD. The FMR states that “when either the procurement contracting officer or the contract administrative office receives information that bankruptcy proceedings have been initiated, the receiving office shall immediately notify DFAS-GA/CO.” The FMR also requires DoD Components to inform the Office of General Counsel of their cognizant agency. The notification is required “regardless of whether any contracts have fully been performed, closed, or terminated.” The notification is to be made within 3 workdays of the receipt of the notice of bankruptcy. If the contracting officer receives the notification of bankruptcy from the debtor or from DFAS-GA/CO, the contracting officer is required to prepare and send a report on the bankruptcy to DFAS-GA/CO and the cognizant legal office, no later than 15 days after the receipt of the notice. The report is to include the name of the contractor, a list of contracts, and the amount of the claim against the contractor. The purpose of this notification is to enable DFAS-GA/CO to prepare a consolidated proof of claim and to forward the claim to the Department of Justice, Central Intake Facility.

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## Management of RMT Contracts

DNSC management of the FY 2000 and FY 2001 contracts awarded to RMT for the sale and removal of tin was inadequate. DNSC held two contract specialists accountable for the mismanagement of these contracts. The two General Schedule 13 (GS-13) contract specialists were given written letters of reprimand that were not included in their permanent personnel records. According to the DNSC position description, a GS-13 contract specialist's duties include performing all aspects of contract administration, monitoring or personally administering contracts through all stages of performance, and developing and maintaining systems to evaluate and monitor contractual performance in areas such as delivery and cost. According to the DNSC position description, the supervisory contract specialist, or contracting officer (GS-14), "is responsible for directing and coordinating contracting activities related to the acquisition or sales of strategic and critical materials required for or excessed from DNSC." DNSC supervisory contract specialists were contracting officers. However, not all DNSC contracting officers were supervisory contract specialists. The supervisory contracting officers supervise a staff of contract specialists and assistants. Contract management is, therefore, the responsibility of both contract specialists and contracting officers and not contract specialists alone. Both DNSC contracting specialists and contracting officers managed the RMT contracts ineffectively. However, DNSC did not hold the contracting officers accountable for the mismanagement of the RMT contracts.

The Director, Directorate of Stockpile Contracts stated that sales solicitations are part of DNSC sales contracts. The contracts we reviewed incorporated the solicitations as part of the sales contract. The first two contracts were awarded under one solicitation. The third contract was awarded under a separate solicitation. DNSC negotiated the terms of all three contracts.

**Contracts Terms.** DNSC contracting officers and contract specialists did not effectively and efficiently enforce the terms of the RMT contracts. RMT did not pick up the monthly minimum quantities agreed to in the contracts. RMT made partial rather than full payment for items removed from DNSC depots. The Director, Directorate of Stockpile Contracts allowed RMT to continue to make payments by checks drawn on foreign banks, contrary to the provisions in the contracts.

**Removal of Monthly Minimum Quantities.** RMT did not pick up the minimum quantities they agreed to pick up for each month of the contract period. The contracts required RMT to notify the DNSC contracting officer, in writing, of the quantity of tin to be picked up each month, with the minimum quantity being the contract amount. DNSC called this date the declaration date. Each of the three contracts contained a minimum monthly quantity that RMT was required to pick up. DNSC did not charge RMT storage fees for pick ups that were under the minimum monthly quantity. The Director, Directorate of Stockpile Contracts stated that because she expected RMT to remove the total contracted quantities by the end of the contract period, DNSC did not bill RMT for the individual months of the contract period when the declared minimum quantity was not picked up or

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when the quantity picked up was less than the contract amount. That explanation does not comply with the terms of the RMT contracts.

The solicitations, which were incorporated into the contracts, stated that storage fees shall be assessed on all materials not removed in accordance with the contract period. The solicitations also stated that the removal period for the tin sold shall be one calendar year from the date of contract award. In addition, “the contractor shall remove no less than the monthly removal minimum and no more than the removal maximum of the material (as specified in I.3 Anticipated [Commodity] Removal Schedule) awarded under this contract each calendar month following contract award until all material purchased under this contract is removed.” The RMT Anticipated Commodity Removal Schedule indicated the minimum and maximum quantity to be removed each month during the contract period. In addition, RMT declared in writing the monthly quantities of tin it agreed to remove. We do not believe that RMT should have been exempted from paying storage fees for the months that the declared minimum quantity was not picked up because storage fees are required by FMR volume 12, chapter 22, section 220309. The following are examples of when RMT should have been charged storage fees, but was not.

- In October 2000, RMT did not declare the minimum quantity to be picked up, as stated in the RMT removal schedule for two contracts. DNSC did not bill RMT for storage fees for tin that was not removed, as agreed to in the contracts and as required by FMR.
- 9 of 11 monthly removals on one contract were for less than the negotiated minimum quantities. DNSC did not bill RMT storage fees on tin that was not removed, as agreed to in the contract and as required by FMR.
- On one monthly removal for another contract, RMT picked up less than the negotiated minimum quantities. DNSC did not bill RMT for storage fees on tin that was not removed, as required by the contract and by FMR.

**Payment Terms.** DNSC contracting officials did not enforce the contract payment terms. All three of the contracts we reviewed contained payment terms that DNSC negotiated. At the beginning of each month, DNSC notified RMT of the unit price of tin for that month. At the end of the month, RMT informed the contracting officer in writing (the declaration date) of the total “quantity to be picked up for that month and at that unit price.” The unit price changed from month-to-month. However, once the unit price was established for quantities declared for pick up during that month, the unit price did not change, even if the actual pickup occurred in a different month.

For two of the three contracts, payments were due in full for the tin that was removed and for storage fees for tin that was not removed, 30 calendar days after the declaration date for the amount of material removed. On the third contract, payment was due in full for the monthly tin that was removed and for storage fees for tin not removed, 15 days after the declaration date for material removed. Each monthly removal occurred in a series of shipments during the month that DNSC

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recorded on outbound storage reports. On one contract, RMT removed the items purchased in 66 shipments over a period of 11 months. On another contract, the removal was completed in 73 shipments over a period of 10 months. DNSC stopped shipment on the third contract in the fourth month, after 11 shipments. RMT made partial payments on 13 of the 25 monthly removals and no payment on 12 of the 25 monthly removals. See Appendix C for more details. As previously stated, DNSC did not bill RMT for the months in which the minimum quantities removed were lower than the negotiated quantity or for the months that no tin was removed. In addition, DNSC allowed RMT to remove materials without making payments. In both a telephone conversation on August 17, 2001, and in a memorandum on August 30, 2001, DNSC informed RMT that no additional material would be released until delinquent accounts were brought up to date. DNSC gave that notice after RMT had failed to pay its creditors and had stopped all incoming business.

**Payments on Foreign Banks.** DNSC allowed RMT to make payments with checks drawn on foreign banks. The contract solicitations required that RMT make payments in U.S. dollars or by checks drawn on a U.S. bank or a U.S. branch of an acceptable foreign bank. DNSC accounting officials and contract specialists told us that they brought the RMT payment practice to the attention of the Director, Directorate of Stockpile Contracts. The director allowed RMT to continue with the payment practice. In a June 29, 2001, letter to RMT, DNSC granted the RMT request to continue with the payment practice because RMT had relied on this payment practice when it negotiated the three contracts we reviewed. However, the director also stated that RMT would be required to comply with the contract payment terms on all future sales contracts.

**Interest Charges.** DNSC did not charge RMT the interest charges for late or partial payments as stated in the contracts. The solicitations included provisions for interest charges at rates established by the Secretary of the Treasury if amounts were not paid by the due date. All RMT payments we reviewed were late. In addition, RMT payments were for the quantities it had declared to pick up and not for the actual quantities picked up. Had DNSC monitored the RMT contracts effectively, DNSC could have observed RMT payment practices and billed RMT for interest charges on the partial and late payments. See Appendix C for more details.

**Release of Materials.** DNSC contracting officers released materials to RMT without checking the DNSC database to ensure that RMT had paid for the materials they previously picked up. Data on materials released to and payments made by RMT were maintained in the DNSC local Paradox database. DNSC Directorate of Operations input the shipment data from the outbound storage report into the database. The Directorate of Resource Management input payment data into the database. Supervisory contract specialists approved the release of materials. The solicitations stated that “no material will be shipped until all outstanding delinquent charges and payments have been satisfied.” Contracting officials were required to access the database to ensure that RMT had paid for previous releases and was not delinquent in its payments before approving the release of additional materials. The contracting officials we talked to indicated that they did not access the database to verify RMT payment history before approving the release of additional materials. As a result, DNSC did not detect

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and prevent RMT delinquency, and RMT was able to pick up material without making full or partial payments for previously released material.

## Financial Management

**Title to Inventory.** DNSC passed title of tin to RMT at the time the contracts were awarded and not when deliveries were made. DNSC lost title to about \$13.5 million of tin that RMT had picked up before filing for bankruptcy. DNSC officials told us that DNSC passed title to RMT because of a report issued by the Inspector General of the Department of Defense (IG DoD). IG DoD Report No. 98-166, "Internal Controls and Compliance With Laws and Regulations for the FY 1997 National Defense Stockpile Transaction Fund Financial Statements," June 25, 1998, stated that to match revenue and expenses correctly, DNSC should recognize revenues and cost of goods sold at the same time. Before the report, DNSC recognized revenue when contracts were executed and the cost of goods sold when deliveries were made. DNSC was not matching revenues with cost of goods in the same accounting period and continued to maintain title to materials after contracts were awarded. The intent of the report was for DNSC to correctly match revenue and the cost of goods sold. The delivery of tin to RMT was based on a delivery schedule that was agreed to during the contract period. Based on the instructions in SFFAS 3, SFFAS 7, and FMR, DNSC should have passed title to RMT when deliveries were made, not when contracts were executed. DNSC has since changed its policy and is not passing title of materials sold to contractors at the time contracts are awarded.

**Billing and Collection.** DFAS performed DNSC billings. DFAS billing invoices to RMT contained payment terms that were different from the RMT contract terms and from the FMR. The billing invoices were reasonably timely. FMR volume 12, chapter 22, requires stockpile sales and disposal to be billed shortly after the sales agreement is made or at the time of scheduled delivery or pickup. The payment terms on the billing invoices did not agree with FMR or terms of the RMT contracts. For example, the first shipment on the third RMT contract occurred from May 3, 2001 through May 8, 2001. The contract terms required RMT to make payments 15 calendar days after the declarations date. On that shipment, the declaration date set by RMT was June 1, 2001. Based on the contract, the due date for the payment of that shipment should have been June 16, 2001. DFAS billed RMT for this shipment on June 27, 2001. The payment terms on the invoice was 30 days from the date of the invoice. All the DFAS billing invoices we reviewed included payment terms that were different from the terms of the RMT contracts and the FMR.

**Debt Management.** DNSC did not have an effective debt control program. DNSC contracting officers did not aggressively and proactively collect RMT debts to the Government by implementing DoD debt management policies. We were not able to obtain a copy of the aged DNSC debts at the time DNSC became aware that RMT had filed for bankruptcy. However, when RMT filed for bankruptcy, the amount owed per shipment on the first contract we reviewed averaged about 208 days past due. Amount owed per shipment on the second RMT contract averaged about 224 days past due. See Appendix C for the number

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of days payments were past due, per shipment and contract. See Appendix D for DNSC aged accounts receivable as of April 11, 2003. We believe that DNSC contracting officers should have known that RMT was delinquent in its payments and should have taken aggressive actions to collect the debt. RMT payment history was available in the DNSC Paradox database. DNSC contracting officers did not issue demand letters to RMT for payment of its debts, as required by FMR. In addition, because the contracting officers did not initiate the collection of contractor debts, they did not document their administrative debt collection activities, which is also a requirement of the FMR.

**Transfer of Delinquent Debts.** DNSC did not transfer delinquent debts to DFAS for collection. According to FMR volume 10, chapter 18, debts that are 180 days delinquent are to be transferred to the Department of the Treasury for collection. DFAS is responsible for the transfer of DoD debts to the Department of the Treasury. Because of the IG DoD Report No. 98-166, DFAS sent a memorandum to DNSC on August 10, 1998, stating that it will assume all DNSC delinquent accounts receivable responsibilities. According to the memorandum, “A final decision from the contracting officer is required prior to issuance of a demand letter for indebtedness. All indebtedness letters will be legally insufficient without the contracting officer’s final decision, which would prevent additional action by the [DFAS] Debt Management Office.” DNSC contracting officers did not issue demand letters to RMT. In addition, DNSC was not able to provide any documentation or evidence that it had forwarded any of the delinquent debts to DFAS for collection. See Appendix C for the number of days that RMT payments were delinquent and Appendix D for DNSC aged accounts receivable.

## Amount of Claim

**Alleged Amount Lost.** We substantiated the Defense Hotline allegation that DNSC lost about \$13.5 million, and potentially more, on the sale of tin to RMT. The amount owed does not include interest charges for late or partial payments and does not include storage fees, which is contrary to the agreed-upon terms of the three contracts. If DNSC had enforced the terms of the RMT contracts and had billed RMT for storage fees for the minimum quantities not picked up and interest on partial or late payments, the amount that RMT owed to DNSC would have been more than \$13.5 million. We did not attempt to determine the amount of interest that RMT would have owed. However, on August 1, 2001, 14 days before the bankruptcy filing, DFAS billed RMT \$43,072 for interest charges on one contract for shipments made from February through June 2001. At the time DFAS billed RMT for interest charges, RMT was seriously delinquent in its payments. DNSC was responsible for computing interest and storage fees on the RMT contracts. DNSC did not comply with FMR policies on interest and penalty charges. DNSC lost the \$13.5 million because of poor contract management. The following table shows the amount owed on the three contracts we reviewed.

<b>Amount Lost Per Contract</b>				
Does not include interest and storage fees				
<u>Contract</u>	<u>Estimated Contract Value*</u>	<u>Actual Contract Value*</u>	<u>Amount Received</u>	<u>Amount of Claim</u>
First Contract (SP0833-00-S-00233)	\$13,847,644	\$13,466,586	\$ 9,065,285	\$ 4,401,301
Second Contract (SP0833-00-S-00234)	16,455,796	16,363,172	11,655,555	4,707,617
Third Contract (SP0833-01-S-10129)	<u>11,134,950</u>	<u>4,390,508</u>	<u>0</u>	<u>4,390,508</u>
<b>Total</b>	<b>\$41,438,390</b>	<b>\$34,220,266</b>	<b>\$20,720,840</b>	<b>\$13,499,426</b>
*Contract value is an estimate based on the total weight of tin to be picked up. The actual contract value is based on the actual weight of tin picked up.				

**Filing Proof of Claim in Bankruptcy Cases.** DNSC, not DFAS-GA/CO, filed a proof of claim in the RMT bankruptcy case. The amount claimed would not have been different if DFAS-GA/CO had filed the claim. DNSC officials stated in an e-mail message to us that they had discussed the RMT bankruptcy filing with their cognizant agency, Defense Logistics Agency, General Counsel, but said they had not notified DFAS-GA/CO. As stated in the FMR, DFAS-GA/CO is responsible for preparing a consolidated proof of claim and for forwarding the claim to the Department of Justice, Central Intake Facility.

## New Contract Initiatives

DNSC has initiated a new program for the sale of national stockpile materials, including tin, and is using a new accounting system. Under the new program, the Basic Ordering Agreement, contractors pre-register to participate in the program. DNSC establishes a financial exposure limit for each contractor based on the financial position of the contractor, past performance, references, and credit report. Once contractors reach their financial exposure limit, they are not able to participate in future sales until they are satisfactorily performing on existing contracts or DNSC increases their financial exposure limit. DNSC is also replacing its Paradox database with the Defense Working Capital Accounting System (DWAS) that will require contracting officers to review contractor performance before awarding new contracts or approving additional releases of items on existing contracts. DNSC has also designed a standard “demand for

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payment” letter to send to contractors when they are in default of their payment terms. In addition, DNSC has decided not to pass title of commodities sold to contractors at the time contracts are executed.

We reviewed two Basic Ordering Agreements. We were unable to obtain policies and procedures on how financial exposure limits are calculated. We received the DWAS Instruction Overview, April 2003, which is an instructional manual for upper-level management. We were unable to obtain any standard operating procedures for DWAS. We do not believe that pre-qualifying contractors necessarily guarantees contractor performance, and DNSC should not consider that practice a substitute for good contract management or performance monitoring. The new initiatives by DNSC are improvements over the old system; however, the controls for monitoring contractor performance in DWAS also existed in the old Paradox database. We do not believe that the new initiatives will detect and prevent the loss of Government funds from contractor non-performance as long as contracting officials are not enforcing the terms of contracts.

## **Recommendation**

**Revised Recommendation.** We expanded Recommendation A. to further clarify the need to ensure that contracting officers are held accountable for their responsibilities.

A. We recommend that the Director, Defense Logistics Agency provide oversight, guidance, and direction to the Administrator, Defense National Stockpile Center to ensure that the Administrator, Defense National Stockpile Center enforces the terms of all contracts and adheres to DoD financial management policies and procedures for contract administration and to ensure that contracting officers are held accountable for their responsibilities.



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## **B. Compliance With DoD Management Control Program**

DNSC did not comply with DoD Management Control Program. That condition occurred because the DNSC Directorate of Resources Management and the Directorate of Stockpile Contracts did not perform the required management reviews in the DNSC Management Control Program. As a result, DNSC failed to identify and correct contractor non-performance that resulted in a loss of about \$13.5 million to the Government. In addition, incorrect assertions were made in the DNSC Annual Statements of Assurance for FY 2001 and FY 2002. The FY 2002 Statement also omitted additional required information of potential accounts receivable losses.

### **Criteria**

DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, requires DoD Components to establish a management control program to review, evaluate, and report on the effectiveness of its management control program and to take appropriate action to identify and correct ineffective controls. DoD Components are required to submit an Annual Statement of Assurance based on management's assessment of the effectiveness of the management control program. DoD Instruction 5010.40 also requires that the Statement of Assurance be based on the Office of Management and Budget memorandum, "Year-End Internal Control Report," (current edition), FMR, and SFFAS. Under SFFAS No.1, "Accounting for Selected Assets and Liabilities," March 30, 1993, "losses on receivables should be recognized when it is more likely than not that the receivable will not be totally collected. The phrase more likely than not means more than a 50 percent chance of loss occurrence."

### **DNSC Management Control Program**

DNSC did not comply with the requirements of the DoD management control program. The Directorate of Resources Management and the Directorate of Stockpile Contracts did not perform the required management reviews in the DNSC management control plan. We reviewed the management control plan as it related to the objectives of our audit. DNSC management control plans for FY 2001 and FY 2002 included plans for test cash collection processes, accounts receivable reviews, and periodic reviews of the work of contract specialists for compliance with standard operating procedures. The Directorate of Resources Management was responsible for the first two reviews and the Directorate of Stockpile Contracts was responsible for the third review. The directorates were required to provide management review comments to the DNSC internal review officer after performing the reviews. Individuals responsible for the reviews told us that the reviews were performed as part of their daily functions. Both the directorates and the internal review officer were not able to provide us with

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documentation on the results of the reviews. We believe that if the required reviews had been performed, DNSC would have been able to identify the overdue account balances and take timely corrective actions to prevent or minimize the amount lost by RMT defaulting on its contracts.

## **FY 2001 Annual Statement of Assurance**

The FY 2001 Statement of Assurance (FY 2001 Statement) was not reliable and contained information that could not be supported because it reported that DNSC accounting and administrative controls were evaluated in accordance with the guidance provided in DoD directives and instructions on the management control program. DoD instructions require the documentation of the reviews to include management's opinion on the effectiveness of the management controls. DNSC officials responsible for the management control plan were not able to provide us with documentation on the results of their reviews.

**Aged Accounts Receivable.** The aged accounts receivable balance reported in the FY 2001 Statement could not be supported. According to the FY 2001 Statement, there were no material weaknesses in the procedures used to process cash collections. The Statement also reported that as of September 30, 2000, the DNSC aged accounts receivable was \$21,601,063. The aged accounts receivable balance of that amount as of July 31, 2001, was \$5,533,877, and \$4,577,725 had been forwarded to DFAS-Columbus for debt collection. Based on our review of RMT contracts, there were no material weaknesses in the procedures used to process cash collections. However, the FY 2001 Statement presentation of the aged accounts receivable balance was not accurate. The amount reported as aged accounts receivable was \$21,601,063, but the total receivable was actually \$206,596,215. DFAS classified \$27,169,533 (13.2 percent) as aged or delinquent, not \$21,601,063 as reported in the Statement. \$5,613,883 of the \$27,169,533 was 2 to 10 years delinquent. On May 26, 2003, DFAS informed us that the last time DNSC transferred any account to them for collection was in January 2000.

In addition to the aged accounts receivable balance as of September 30, 2000, we also reviewed the DNSC aged accounts receivable balance as of April 11, 2003. As of April 11, 2003, the aged accounts receivable balance was \$35,148,470. See Appendix D for more details.

**Contract Specialist Work Reviews.** DNSC did not perform quarterly reviews of the work of the contract specialists as planned. The DNSC FY 2001 management control plan included quarterly reviews of the work of the contract specialists. However, DNSC could not provide us with the results of the quarterly reviews. DNSC provided us with a copy of an undated and unsigned memorandum from a procurement analyst to the Director of Stockpile Contracts that discussed the results of a random audit of 20 sales contracts from FY 2000 and FY 2001. The memorandum concluded, among other things, that there were no indications in the contract files that the contracting officers or team leaders performed at least a cursory review of documents before issuance. DNSC stated that the memorandum was the result of the required review indicated in the management control plan. The memorandum did not meet the requirements of DoD Instruction

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5010.40. The FY 2001 Statement indicated that standard operating procedures and contracting instructions had been developed because of random quarterly reviews of sales and acquisition files. The FY 2001 Statement also reported that “contract administration is not being adequately performed on contracts containing payment terms, resulting in a potential loss of over \$10 million.” The FY 2001 Statement classified that as a deficiency and the proposed remedy included auditing contract payments on a quarterly basis and a review of contractor financial responsibilities. The FY 2001 Statement was prepared after DNSC became aware of the RMT bankruptcy filing. DNSC held two contract specialists **accountable** for not monitoring the RMT contracts and reprimanded them. However, DNSC did not hold the contracting officers accountable for the mismanagement of the RMT contracts. We believe that if the reviews had been done in accordance with the DNSC management control plan, contracting officers could have provided adequate management of the RMT contracts.

## **FY 2002 Annual Statement of Assurance**

We believe that DNSC FY 2002 Statement of Assurance (FY 2002 Statement) could not be supported. Additionally, required information on potential loss of accounts receivable was not included in the FY 2002 Statement. We compared the FY 2002 Statement to the FY 2002 DNSC management control plan and found that required reviews were not done. The management control plan requires tests of cash collection processes to ensure accuracy, reviews of account receivables to minimize the total amount receivables, and quarterly reviews of the work of the contract specialists in order to verify compliance with standard operation procedures, which was similar to the FY 2001 DNSC management control plan. The FY 2002 Statement indicated that the reviews had been conducted and that there were no accounts receivable losses to be reported for the year, which was incorrect. In FY 2002, the \$13.5 million owed by RMT was in litigation. Because the DNSC claim to RMT assets is unsecured and RMT was in bankruptcy, DNSC was aware of the potential loss of the \$13.5 million owed by RMT and according to SFFAS No. 1, should have disclosed that amount in the FY 2002 Statement. The FY 2002 Statement also stated that standard operating procedures were providing the required controls. However, the DNSC FY 2002 management control plan required a quarterly review of the work of contract specialists, but DNSC could not provide us with the results of such reviews.

## **Recommendation**

B. We recommend that the Director, Defense Logistics Agency provide oversight, guidance, and direction to the Administrator, Defense National Stockpile Center to ensure that Defense National Stockpile Center directorates implement the Defense National Stockpile Center management control program and document the control program reviews in accordance with DoD management control program instructions.

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## Appendix A. Scope and Methodology

We reviewed FY 2000 and FY 2001 contracts between DNSC and RMT for the sale and removal of tin. We reviewed the billing invoices that DFAS sent to RMT, RMT payment history, and DNSC deposit slips for RMT payments. We reviewed a sample of DNSC contracts for the removal of asbestos. We reviewed DNSC aged accounts receivable as of September 30, 2000, and April 11, 2003. We reviewed the new DNSC contract procedures for the sale of tin and contract close out procedures. We also reviewed DNSC management control plans and the DNSC Annual Statements of Assurance for FY 2001 and FY 2002. In addition, we interviewed current and former DNSC employees.

We performed this audit from February through August 2003 in accordance with generally accepted government auditing standards.

**Use of Computer-Processed Data.** We relied on computer-processed data provided to us by DNSC from DFAS accounting systems to determine the accounts receivable balances. We did not evaluate the general and application controls of the systems that produced the accounts receivable balances. Not evaluating the controls did not affect the results of the audit.

**General Accounting Office High-Risk Area.** The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the DoD contract management high-risk area.

### Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

**Scope of the Review of the Management Control Program.** We reviewed the adequacy of management controls over contract administration and the processing of contractor payments. Specifically, we reviewed controls over the contractor selection process, the release of materials to contractors, the input of released materials into the DNSC accounting systems, and contract administration for the sale of tin. We reviewed the controls relating to the processing and collection of payments drawn on foreign banks. We also reviewed the adequacy of management's self-evaluation of those controls and the resulting Annual Statements of Assurance for FY 2001 and FY 2002.

**Adequacy of Management Controls.** We identified material management control weaknesses for DNSC, as defined by DoD Instruction 5010.40. DNSC management control plans for conducting management control reviews were not adequate to ensure that the reviews were actually being performed and that the DNSC Annual Statements of Assurance for FY 2001 and FY 2002 were

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supported by accurate and verifiable information. Recommendation B., if implemented, will correct the identified weaknesses. A copy of this report will be provided to the senior official responsible for management controls at the Defense Logistics Agency.

**Adequacy of Management’s Self-Evaluation.** DNSC officials identified contract administration and accounts receivable reviews as assessable units but did not perform the evaluations. DNSC officials could not provide us with any documentation that management reviews on contract administration or reviews of aged accounts receivables had been conducted.

## **Prior Coverage**

During the last 5 years, the General Accounting Office (GAO) and the IG DoD have issued three reports discussing the National Defense Stockpile Center. Unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov>. Unrestricted IG DoD reports can be accessed at <http://www.dodig.osd.mil/audit/reports>.

### **GAO**

GAO-01-17, “National Defense Stockpile-Improved Financial Plan Needed to Enhance Decision-Making,” January 26, 2001

### **IG DoD**

IG DoD Report No. 99-044, “Strategic and Critical Materials in the Defense National Stockpile,” December 3, 1998

IG DoD Report No. 98-166, “Internal Controls and Compliance With Laws and Regulations for the FY 1997 National Defense Stockpile Transaction Fund Financial Statements,” June 25, 1998

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## Appendix B. Landfill Contract for the Removal of Asbestos

**The Allegation.** The Government lost about \$900,000 on a landfill contract for the removal of asbestos at the Defense National Stockpile Center that was awarded to a “favorite contractor,” rather than to the Army Corps of Engineers whose bid was lower than the awarded contract amount. The Government lost the funds “because of irregularities, bad policy authorized by top management, and procrastination.”

**Review Results.** We were unable to substantiate the allegation that DNSC lost \$900,000 because of procrastination, irregularities, and bad management decisions in the award of a landfill contract for asbestos removal. The Director, Directorate of Stockpile Contracts informed us that DNSC received an unsolicited proposal from Pine Bluff Arsenal, and not from the Army Corps of Engineers, for the removal of asbestos from the base. The director was not able to provide us with a copy of the proposal. The director indicated that even if Pine Bluff Arsenal’s proposal had been lower than the awarded contract, Pine Bluff Arsenal would not have been awarded the contract because the asbestos removal contract was a “small business set aside contract” for small and disadvantage businesses. Additionally, DNSC considers asbestos removal as a service contract, and the Army Corps of Engineers cannot bid on a service contract. We contacted personnel at Pine Bluff Arsenal, but they were also unable to provide us with the copy of their proposal for the project. The official at Pine Bluff Arsenal indicated that she was aware of the proposal, but because of personnel changes and the passage of time, Pine Bluff Arsenal could not locate and provide us a copy of the proposal.

## Appendix C. Number of Days Payments Were Overdue Per Contract Terms

**Table C-1. Contract One**  
SP0833-00-S-00233

Pickup Per Contract	Amount Due On Pickup	Payment Due Date Per Contract Terms	Amount Paid by RMT	Date DNSC Received Last Payment From RMT	Number of Days Payment Was Overdue	Balance Due	Number of Days Overdue as of 8/15/2001 (Bankruptcy)
1	\$ 1,679,547	07/31/2000	\$1,650,143	09/25/2000	56	\$ 29,404	380
2	568,241	08/30/2000	557,764	11/14/2000	76	10,477	350
3	1,119,524	10/02/2000	1,098,993	12/04/2000	63	20,531	317
4	2,549,611	10/30/2000	2,509,937	02/16/2001	109	39,674	289
5*	0	n/a	0	n/a	n/a	0	n/a
6	1,107,308	01/02/2001	1,086,868	05/17/2001	135	20,440	225
7	1,105,098	02/01/2001	1,084,633	05/18/2001	106	20,465	196
8	1,098,859	03/02/2001	1,076,947	07/02/2001	122	21,912	167
9	1,068,202	03/30/2001	0	n/a	n/a	1,068,202	138
10	1,073,196	04/29/2001	0	n/a	n/a	1,073,196	108
11	1,058,565	05/30/2001	0	n/a	n/a	1,058,565	77
12	<u>1,038,435</u>	06/30/2001	<u>0</u>	n/a	n/a	<u>1,038,435</u>	46
<b>Total</b>	<b>\$13,466,586</b>		<b>\$9,065,285</b>			<b>\$4,401,301</b>	

\*RMT did not pick up any material as agreed to in the contract.

**Table C-2. Contract Two**  
**SP0833-00-S-00234**

Pickup Per Contract	Amount Due On Pickup	Payment Due Date Per Contract Terms	Amount Paid by RMT	Date DNSC Received Last Payment From RMT	Number of Days Payment Was Overdue	Balance Due	Number of Days Overdue as of 8/15/2001 (Bankruptcy)
1	\$ 1,995,678	07/31/2000	\$ 1,960,330	09/20/2000	51	\$ 35,348	380
2	1,125,171	08/30/2000	1,105,608	11/09/2000	71	19,563	350
3	2,161,096	10/02/2000	2,118,676	12/12/2000	71	42,420	317
4	3,741,205	10/30/2000	3,676,611	03/26/2001	147	64,594	289
5*	0	n/a	0	n/a	n/a	0	n/a
6	1,424,762	01/02/2001	1,398,598	04/24/2001	112	26,164	225
7	1,410,949	02/01/2001	1,395,732	06/05/2001	124	15,217	196
8	1,415,920	03/02/2001	0	n/a	n/a	1,415,920	167
9	1,391,833	03/30/2001	0	n/a	n/a	1,391,833	138
10	1,381,346	04/29/2001	0	n/a	n/a	1,381,346	108
11	<u>315,212</u>	05/30/2001	<u>0</u>	n/a	n/a	<u>315,212</u>	77
<b>Total</b>	<b>\$16,363,172</b>		<b>\$11,655,555</b>			<b>\$4,707,617</b>	

\*RMT did not pick up any material as agreed to in the contract.



**Table C-3 Contract Three**  
SP0833-00-S-10129

Pickup Per Contract	Amount Due On Pickup	Payment Due Date Per Contract Terms	Amount Paid by RMT	Date DNSC Received Last Payment From RMT	Number of Days Payment Was Overdue	Balance Due	Number of Days Overdue as of 8/15/2001 (Bankruptcy)
1	\$1,456,090	06/18/2001	\$0	no payment received		\$1,456,090	58
2	1,031,068	07/17/2001	0	no payment received		1,031,068	29
3	805,755	08/15/2001	0	no payment received		805,755	0
4	<u>1,097,595</u>	*	<u>0</u>	no payment received		<u>1,097,595</u>	0
<b>Total</b>	<b>\$4,390,508</b>		<b>\$0</b>			<b>\$4,390,508</b>	

\*Declarations were made at the end of the month. DNSC stopped shipment during the month.

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## Appendix D. Defense National Stockpile Center Aged Accounts Receivable

Aged Accounts Receivable as of April 11, 2003		
Age of Accounts Receivable	Total Receivable	Percent of Total Receivable
Under 30 days	\$ 9,644,262	27.4
31 – 60 days	171,550	0.5
61 – 90 days	24,051	0.1
91 – 180 days	1,319,449	3.8
181 – 360 days	2,904,096	8.3
Over 360 days	<u>\$21,085,062</u>	<u>60.0</u>
<b>Total</b>	<b>\$35,148,470</b>	<b>100*</b>
* Difference due to rounding		

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## **Appendix E. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense for Acquisition, Technology, and Logistics  
Under Secretary of Defense (Comptroller)/Chief Financial Officer  
Deputy Chief Financial Officer  
Deputy Comptroller (Program/Budget)  
Director, Defense Procurement and Acquisition Policy

### **Department of the Army**

Auditor General, Department of the Army

### **Department of the Navy**

Naval Inspector General  
Auditor General, Department of the Navy

### **Department of the Air Force**

Auditor General, Department of the Air Force

### **Unified Command**

Inspector General, U.S. Joint Forces Command

### **Other Defense Organizations**

Director, Defense Finance and Accounting Service  
Director, Defense Logistics Agency  
Administrator, Defense National Stockpile Center

### **Non-Defense Federal Organization**

Office of Management and Budget

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## **Congressional Committees and Subcommittees, Chairman and Ranking Minority Member**

Senate Committee on Appropriations  
Senate Subcommittee on Defense, Committee on Appropriations  
Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
House Committee on Appropriations  
House Subcommittee on Defense, Committee on Appropriations  
House Committee on Armed Services  
House Committee on Government Reform  
House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform  
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform  
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform

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